

Eliminate the 1% Residential property tax cap

Explain proposal:

Under the Arizona Constitution (Article 9, Section 18), the maximum amount of primary property taxes that can be collected on a residential, owner occupied property in any tax year cannot exceed one percent of property's full cash value. This 1% limitation only applies to Primary taxes. Primary taxes are assessed on the limited value and used for the maintenance and operations budgets of the various tax jurisdictions. Voters added the 1% limitation to the constitution in 1980 to protect themselves from unreasonable increases in homeowner property taxes.

The 1% limitation doesn't apply to secondary tax assessments. Secondary taxes are assessed on the full cash value and are used to pay for debt service (principal and interest) on bonds, budget overrides, and special district levies. Secondary property taxes for bond debt service, budget overrides, and most levies by special property tax districts require voter approval.

The Legislature doesn't have the authority to change the Constitution. The Legislature can refer constitutional amendments to the voters.

The proposal before this commission is the elimination of the 1% residential property tax cap on primary taxes.

Please see appendix A for a list of the 30 tax jurisdictions that appear to be above the 1% limitation in FY 03 per JLBC.

Please see appendix B for DOR preliminary analysis on the tax impact from eliminating the 1% residential property tax cap.

How to administer this tax reform:

Systems and personnel are already in place at the County and State to administer and collect the residential property tax. The County Assessor determines the full cash and assessed taxable value. The County Treasurer prepares and collects the tax bills.

Impact of this tax reform on Existing Revenue Systems:

The residential property tax cap is primarily administered at the County level. A voter-approved change in the 1% limitation on the primary tax should result in minimal administrative costs to the County or State Government. The County will continue to determine residential property values and collect the tax. State & Counties can reduce administrative costs incurred to track the limitation. State can reduce cost of subsidies made to high primary tax rate jurisdictions.

After the homeowners rebate of 35%, the 1% cap affects ~30 tax jurisdictions. Per DOR, State subsidies to tax jurisdictions above the 1% cap was ~11M. Eliminating the cap results in a tax increase on homeowners in those jurisdictions.

Elimination of the 1% cap will make other property tax proposals before the CFRC less problematic. The proposal to reinstate a new statewide property tax would have the obvious impact of increasing the number of residential property taxpayers exceeding the 1% cap. In addition, proposals to decrease business assessment ratios for primary taxes will have the effect of increasing residential property taxes and increasing the number of residential properties above the 1% cap.

Cost to Administer proposal:

Because systems and personnel are already in place at the County and State to administer and collect the property tax, the cost to administer the elimination of the 1% cap should be minimal. Existing systems can be adjusted for changes in assessment ratios, 1% cap adjustments, etc.

Policy Considerations:

Equity

Elimination of the 1% cap improves horizontal equity by eliminating State subsidies to high tax rate jurisdictions & provides local taxing jurisdictions more flexibility in funding their operations.

Removal of the 1% cap also provides the Legislature with opportunities to equalize the property tax burden for all taxpayers (ex. reducing or eliminating the homeowners rebate, creating an equalized single assessment ratio for all taxpayers, etc).

Economic Vitality

The 1% cap helps promote residential development by holding down residential property taxes.

Elimination or narrowing of the disparity between residential and business property taxes will benefit all types of businesses and promote economic activity.

Volatility

The amount of property tax raised each year is moderately stable because of new construction and rising property values.

Simplicity

Elimination of the 1% cap simplifies administration of the property tax system by removing the requirement to track and adjust for the 1% limitation. High tax rate jurisdictions would no longer receive a subsidy from the State.

Elimination of the 1% cap requires a constitutional amendment, approved by a majority of the voters. Voters tend to reject tax increases unless used for specific purposes (ex. improve education funding).

Accountability:

As defined in the Fiscal 2000 study, accountability is “providing links between the revenue raising responsibility and the spending authority so that voters can hold elected officials responsible for both the revenue and spending decisions.” Clearly, the 1% cap frustrates the important criteria of a good fiscal system by breaking the link between the spending decisions of local government and the responsibility of residential taxpayers to participate in the funding those spending decisions.

Economic Impact:

Elimination of the 1% cap results in a property tax increase of ~11M for taxpayers in high tax rate jurisdictions (see Appendix A for list of jurisdictions).

Further, elimination of the 1% cap may provide opportunities for further property tax reform, such as a single assessment ratio on all property.

A single assessment ratio will result in higher homeowner property taxes and lower business property taxes. Homeowners that itemize deductions on their personal income tax returns would be able to lower their Federal & State income tax liability. Lower business taxes will promote economic development, and result in increases in other tax revenues.

Appendix A – Per JLBC, Tax Jurisdictions in excess of 1% Limitation in FY 03:

COUNTY	SCHOOL DISTRICT
Cochise	Bisbee Unified
Cochise	Bowie Unified
Cochise	San Simon Unified
Cochise	McNeal Elementary
Cochise	Ash Creek Elementary
Cochise	Valley Union HS
Gila	Miami Unified
Gila	Hayden-Winkelman Unified
Maricopa	Isaac Elementary
Maricopa	Union Elementary
Maricopa	Roosevelt Elementary
Pima	Tucson Unified
Pima	Empire Elementary
Pinal	Florence Unified
Pinal	Ray Unified
Pinal	Mammoth-San Manuel Unified
Pinal	Superior Unified
Pinal	Maricopa Unified
Pinal	Coolidge Unified
Pinal	Apache Junction Unified
Pinal	JO Combs Elementary
Pinal	Casa Grande Elementary
Pinal	Red Rock Elementary
Pinal	Eloy Elementary
Pinal	Toltec Elementary
Pinal	Stanfield Elementary
Pinal	Picacho Elementary
Santa Cruz	Sonoita Elementary
Yuma	Yuma Elementary
Yuma	Crane Elementary

Appendix B – AZ DOR preliminary analysis on the 1% Residential Cap

Eliminate the 1% Residential Constitutional Cap

The state currently pays the portion of any primary residential tax bill that exceeds a \$10 rate, after the Homeowner's Rebate has been taken into account. In FY03, this occurred in twenty-three school districts. This limit is Constitutional (Article 9, Section 18), and therefore would require a constitutional amendment to eliminate. The \$10 rate is a combination of all of the primary rates that a homeowner pays. It includes county, city, community college and school district rates. As the overall rate in an area climbs toward the \$10 level, a small increase by any one of these types of districts can push the rate over the threshold. The state is then required to pay the portion of the homeowner's bill that represents the amount over \$10. The state then pays the districts directly.

As rates are being set, some political subdivisions have been known to broadcast the fact that homeowners (voters) would not have to actually pay the cost of the increased tax rates, leaving the state to pick up their portion of the overall tab. Business property owners, of course, get no such relief, and must pay their full tax bill. Elimination of the 1% Cap would certainly cause the political subdivisions to reconsider setting rates that ultimately would have to be paid in full by all the taxpayers.

Both the Homeowner's Rebate and this 1% cap are calculated on a parcel-by-parcel basis, as tax bills are being generated. Although it is difficult to estimate the cost of this cap, JLBC estimated the value of the cap to be roughly \$11 million in FY03. Of that, \$8 million was from Tucson Unified School District. The next highest contributor toward the bill was Apache Junction Unified, at \$1.1 million.